At the second balance date – 31 December 1994

NZD = $235 – $170 – $65 = 0
BCD = $200 – $150 – $50 = 0

go146

This anonymous version appears in substitution for the full version of Determination S2: Funding and Hedging Arrangements Denominated in a Foreign Currency in Respect of the Forward Purchase of a Commodity Where Payment is Received at Irregular Periods. The determination is made pursuant to regulations 8 and 10 of the Income Tax (Determinations) Regulations 1987. The determination was signed by R. D. Adair, Deputy Commissioner, on 8 December 1992.

funding and Hedging Arrangements Denominated in Foreign Currency in Respect of the Forward Purchase of a Commodity Where Payment is Received at Irregular Periods

This determination may be cited as "Determination S2: Funding and Hedging Arrangements Denominated in a Foreign Currency in Respect of the Forward Purchase of Commodity where Payment is Received at Irregular Periods".

1. *Explanation* (Which does not form part of the determination)

(1) A has entered into an agreement to purchase commodity in order to pay a cash sum to B. This sum has had to be funded from C, who has provided a loan to A. A is a wholly owned subsidiary of C, and has entered into hedging arrangements with its parent in order to minimise its exposure to commodity price movements. As A and C are able functionally to be treated as one person when characterising this transaction, all financial arrangements within the scope of this determination can be treated as one financial arrangement. That financial arrangement consists of the following. An agreement whereby a holder sells commodity to be delivered in instalments over a period of time, and the issuer pays the full purchase price at the time of entering into the agreement for those deliveries. An agreement whereby the issuer under the agreement for the sale and purchase of commodity borrows the amount of purchase price required to pay the holder under the former agreement. The issuer under the agreement for sale and purchase of the commodity enters into a commodity price option agreement in order to hedge the risk of price movements in the commodity in the period during which the agreement for the sale and purchase of that commodity operates.

(2) This determination applies to all these financial arrangements, together with any consequential financial arrangements arising as a result of deferred settlement of payment obligations under these financial arrangements (as more fully described in this determination) being in all cases financial arrangements denominated in a base currency.

This determination allows an issuer under the agreement for sale and purchase of the commodity to calculate income or expenditure in relation to all of these financial arrangements.

(3) A has agreed to buy and B has agreed to sell quantities of commodity for delivery over 36 months. The amounts of the commodity to be delivered each month are quantified by reference to a schedule of base quantities known at the time the agreement was entered into. The actual amount of commodity to be delivered each month may vary from the agreed base quantities, but only by reference to movements between two commodity indices relative to each other. The actual value of the commodity to be delivered each month expressed in a Base Currency will not change by reason of the fact that there is a movement between these two commodity indices. A will pay a sum on the day of entering into the agreement to B for all future deliveries. Further adjustment to the price is contemplated in the agreement for the sale and purchase of the commodity where the value of the commodity delivered each month exceeds the value of the commodity delivered that month as calculated according to the market value of that commodity during the month in which the agreement was entered into.

(4) A will borrow from C the amount of the purchase price to be paid to B. This loan to A will be denominated in a Base Currency, as will the purchase price paid by A to B. The loan will provide for repayment of principal and interest each month according to a schedule under which the amount to be paid by A every month is equivalent to the value of the base quantity of the commodity B has agreed to deliver to A each month, calculated by reference to the commodity price prevailing in the month the agreement for sale and purchase of the commodity was entered into.

(5) A will enter into hedging arrangements at the time the agreement for sale and purchase of the commodity from B to A, the "Forward Commodity Purchase agreement", is executed. The hedging arrangements will be in the nature of commodity price options, under which A will receive from the other party to the option, in any month for 36 months, an amount if any equal to the difference between the commodity option price ("the floor price") for that month, and an amount calculated by reference to the base quantity of the commodity to be delivered by B to A in that month and by reference to the commodity price prevailing on a recognised market for that commodity in that month expressed in the Base Currency. The amount if any to be paid by the other party in respect of any month under this commodity price option agreement will be calculated on the last day of the month, although actual payment is not required until 35 days thereafter.

(6) A and B have applied for a determination pursuant to section 64E (1) of the Act.

(7) Income or expenditure under the Forward Commodity Purchase agreement will be recognised using a methodology similar to that applied to the income or expenditure arising under the Base Currency Loan between A and C.

(8) The income or expenditure shall, in respect of the Forward Commodity Purchase agreement be recognised on the basis of the lowest price agreed by the parties pursuant to section 64BA (1) (c) (i) of the Act being the market price in the month the Forward Commodity Purchase agreement was entered into.

(9) The parties have entered into this arrangement in order to provide a cash sum to B, in circumstances in which C will not be a direct funder. C has accordingly purchased forward commodity, and taken the commodity risk on price movements which it has hedged.

2. *Reference*—This determination is made pursuant to section 64E(1) of the Act.

3. *Scope of determination*—This determination shall apply to the Forward Commodity Purchase agreement and the funding and hedging arrangements denominated in a Base Currency in respect of the forward purchase and forward payment for commodity entered into between A and B on 7 December 1992 under which the purchase price will be received at irregular intervals, and shall bind both A and B.

4. *Principle*—(1) The Forward Commodity Purchase agreement is an arrangement transferring the commodity pursuant to a financial arrangement expressed in a Base Currency. The Commissioner accepts that the lowest price the parties have agreed and would have agreed for the purposes of section 64BA (1) (c) (i) is the market price of the commodity in the month the Forward Commodity Purchase agreement is entered into. To the extent that the proportion of the agreed lowest price referrable to deliveries in any month exceeds that part of the payment attributable to those deliveries, it shall contain both an element of capital (being part payment of the purchase price), and an element of interest. To the extent to which that proportion of the agreed lowest price referrable to deliveries in any month is less than that part of the purchase price attributable to the commodity delivered, B as the holder under the financial arrangement would have derived income to